Healthcare Economics:

Characteristics of the Healthcare Market, Supply and Demand,
Competition and Equilibrium,
Policy and Regulatory Implications

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For:

CDR Whitmeyer

"Discuss the various methods used to allocate scarce resources in the US health care system. What are the implications of these allocations (in terms of quality, outcomes, efficiency, and equity) and how can the "system" improve its performance by addressing these allocative decisions?"

Rena Nicholas
Brian Mulhall
Michael Nack
Kari Stone
Jeff Tjaden
Kirk Winger

One of the difficulties faced by the modern U.S. healthcare system is that the demand for new and expensive health interventions is exhausting increasingly scarce resources. Items such as organs for transplantation, technologically advanced equipment, and even certain types of healthcare providers are all limited in availability, though increasingly demanded by consumers who desire equitable access to these resources at a reasonable price. This dilemma creates problems for managers and policy makers who are charged with ensuring that these scarce resources are allocated appropriately to those who need them. This allocation process and its basis for economic decision-making is of importance given that the misallocation of resources has a significant impact on the outcomes and future performance of the healthcare system. The U.S. healthcare system is constrained by two philosophies regarding how to manage its resources. Both the free market and the social justice systems are important components of this process; and the U.S. healthcare system incorporates components of both in its policies regarding the allocation of scarce resources. This "hybrid" approach is the prevailing method used in American policy-making; however, the underlying goals of each allocation method can often be in conflict with each other.

Free Market Allocation

To understand the allocation process in the U.S., it is important to understand both the free market and social justice processes. First, the free market approach is usually directed by the economic principles of supply, demand, quantity of resources, and cost of resources. The economics principles assume that individuals in a system will behave rationally to obtain the best utilization/procurement of scare resources. In an ideal system, the functions of supply and demand will indicate an ideal, or equilibrium, price that reflects a good match between the amount of product a producer is willing to provide at a given price (supply) and the amount of the product the consumer is willing to purchase at a given price (demand). This process usually works very well to maintain adequate supplies of products at a reasonable cost to the consumers who purchase them. However, in the healthcare setting, individuals do not behave in an ideal, rational manner to meet their goals. Often, economic variables, such as price, demand, and supply are affected by myriad outside influences. The healthcare system in the U.S. is usually considered an "imperfect" market because it is not regulated solely by the effects of supply and demand (Lee, 2000).

Social Justice Allocation

The culture, climate, and economic circumstances of the American society often dictate that healthcare must operate according to U.S. ideals of "efficiency," "equity," and overall "fairness" in pricing and availability. Therefore, the American public often demands that the government ensure that healthcare, especially life-saving care, is available to those in "need." This cultural philosophy is the hallmark of the social justice approach to allocation of scarce resources. To this end, government and other agency policy-makers are often pressured to impose laws and regulations to ensure prices are maintained and that access to resources is "equitable" and "efficient." Unfortunately, this approach is often difficult because determining who is in "need" and what qualifies as "quality," "efficient," and "equitable" outcomes are difficult. The social justice approach

and the economic circumstances of the U.S. healthcare system have also resulted in the widespread use of insurance as a means for individuals to have access to needed/desired healthcare at a price the consumer is willing to pay (i.e., using co-pays, deductibles, etc.).

Difficulties of Both Methods

Both of these allocation methods are subject to difficulties when placed into practice. On the one hand, the free-market system works well on a macro level of society so that demand (and demand forecasts based on past demand) dictates where supplies are needed most and how much these supplies should cost the consumer. Overall, this process improves efficiency because costs are constrained by demand, as is supply, resulting in fewer hidden costs of surplus. Also, since the supply and demand are at equilibrium, the quality of outcomes can be improved because the time and resources are allocated as they are needed rather than spread across consumers who compete for these resources with those who truly need them. However, this process is not so beneficial to the individual, particularly if s/he is unable to afford the care and/or if s/he is in an area where needed supplies are incredibly scarce or not available at all. Therefore, despite the potential positive outcomes for quality, efficiency, and cost, the inequity of service is apparent and usually unacceptable to society at large. As stated earlier, the American public does not behave in an "economically rational" manner, and each individual desires assurance that if s/he "needs" the healthcare resource, s/he will be able to access it.

Clearly, this social justice approach can therefore counter the gains made using the free-market approach, and thus result in poorer quality, inefficiency, and increased costs overall in order to ensure that resources are allocated equitably. Lee (2000) highlights several adverse outcomes that occur when the social justice method (enforced using laws, regulations, and policies) is employed. For example, since insurance shields the individuals from the true costs of healthcare, the patient can demand services/resources that are unnecessary and/or less effective and efficient because s/he does not directly bear the cost. Over time, however, this inefficient use of resources becomes more costly, not only by increasing demand-driven costs, but also by reducing supply, decreasing quality, and straining a process that is struggling to meet the equity demands of all individuals. Another example is when regulations mandate a certain procedure or certified individual for a certain service in an effort to ensure that "quality" is maintained (i.e., only a "specialist" using an expensive procedure can treat an illness). However, these "higher quality" demands are more expensive and are therefore more costly in the long-term. Often, if these higher expenses are unaffordable, an individual may have to forego treatment entirely. Therefore, the method designed to improve "quality" can actually be more adverse!

The U.S. Allocation Process – A Combined Approach

Despite these inefficiencies and other problems, the U.S. public continues to demand these outside interventions on the healthcare system. Therefore, the U.S. system is most accurately qualified as a "hybrid" of free market and social justice allocation approaches and is subject to the benefits and problems contained in both. The American system is placed in a precarious balancing act of ensuring that quality, equity, efficiency, and cost outcomes are maximized in a positive/"acceptable" manner. This quandary has largely resulted in all outcomes being less than ideal, despite well-intentioned efforts to

improve all areas. However, this allocation process is likely to remain as U.S. healthcare system policy for the foreseeable future. Therefore, it is important to consider the various ways that this process can be improved to maximize equity and quality while minimizing inefficiency and costs.

Difficulties and Potential Improvements for the U.S. Approach

Some of the difficulties inherent in attempts to improve the current healthcare system involve the differing expectations about what constitutes quality, efficient, and/or equitable care. Patients often desire the best, most state-of-the-art care for their illnesses, regardless of whether this level of care is necessarily needed. Therefore, anything that limits the realization of this expectation (i.e., use of generic medications, substitutions, etc.) may be viewed as "inequitable" and "lower-quality" care. On the other hand, since the providers, insurance companies, HMOs, and other administrative entities desire to maximize outcomes (i.e., achieve health improvement) at minimal cost, the use of such substitutes may be viewed as "quality," "equitable," and "efficient" care. This example demonstrates the need for operational definitions of outcomes such as "quality" and "equity." One possibility for defining these outcomes may include a professional body of physicians, researchers, policy-makers, lobbies, and economists who characterize the relevant factors.

Another difficulty in improving the allocation processes in the U.S. healthcare system is that the demand for resources changes as new technologies emerge and as new data is available to define the standard of care for illnesses. Once the information and equipment become available, the determination of who should get access to the new levels of care is is challenging. Economically, the access to new procedures would go to those who are able to pay the associated costs. In a social justice approach, the resources would be allocated to those most in "need" and/or those who would benefit the most. Since the U.S. system attempts to meet the demands of both the social justice and free market constraints, improvement in this area could also center on defining "need." This is an area where the scientific data and professional experience could be most useful. Identification of those who "need" the resources most could enable a more efficient delivery of the care, maximizing benefits, reducing demand as much as is manageable, and therefore minimizing costs.

Additionally, the allocation of scarce resources may occur more ideally if the demand for these resources is diminished. There are two potential processes that can reduce demand for certain resources. The first method could include increased public health education campaigns for preventative medicine. If individuals engage in preventative screenings or healthcare, and lifestyle modifications, the demand for the intense, complicated, and often costly care associated with major/chronic diseases may decrease. Efforts are underway in this area and their effectiveness is currently unknown. However, as time progresses, the benefits of preventative medicine and health education are likely to be realized on some level. The prevention of these diseases would improve efficiency and equity in the care of chronic diseases, which are most expensive and most likely to place the uninsured at an economic disadvantage. A second educational approach for reducing the demand for costly and scarce resources could include increasing public/patients' awareness of the cost, benefits, and overall effectiveness of certain procedures/resources and their associated substitutes. Improved understanding of

the healthcare process, how costs are minimized, and the benefits to the patient in managing costs/efficiency may help in preventing the demand for unnecessary and costly tests and other procedures.

Finally, the U.S. allocation process can be improved by maximizing its use of free market principles where possible while limiting governmental interventions as much as possible. Certainly for medical procedures that are for cosmetic or other non-life-sustaining purposes, free market principles can operate well to contain costs through meeting the equilibrium of supply and demand. For care that is medically "needed," either life-saving or preventative, the allocation processes can operate under an approach that is more guided by social justice philosophies and policies. In this case, limited regulations (that are planned and refined using data and collaborative input) coupled with existing "gate-keeper" policies can assist in ensuring that the allocation of resources is reasonable. Again, this process may not be ideal; however, the attempt to compromise between social justice and free market may optimize the outcomes of this negotiation.

Conclusion

Clearly, there is no single or simple solution to the problem of allocating scarce resources while maximizing positive outcomes. Given the problems inherent in both the free market and social justice allocation methods, neither alone is entirely feasible in the American healthcare system, particularly given the nature of American culture and expectations. However, some improvements to the U.S. health care system's "combined" approach to allocation could be beneficial. These improvements would take time to be implemented and their effects would not be immediately obvious. Nevertheless, maximizing the positive aspects of both the free market system and social justice method could help the system gain some improvements. Attempts to implement such improvements can benefit by following lessons learned from current "blended" social justice and free market models, such as that of the DoD's Tricare system. Careful observation and planning, employing the suggestions listed in this paper, may prove beneficial for the future of the U.S. healthcare system's allocation methods.

Reference: Lee, R.H. (2000). Economics for Healthcare Managers. Health Administration Press: Chicago, IL.